

CENTRAL WATER SYSTEM
INDEPENDENT AUDITORS' REPORT
FINANCIAL STATEMENTS AND FINDINGS
DECEMBER 31, 2006

CENTRAL WATER SYSTEM

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CENTRAL WATER SYSTEM

DECEMBER 31, 2006

OFFICIALS

<u>NAME</u>	<u>TITLE</u>
Jake Hinshaw	Director - Chairman
Del Leiss	Director
Larry Stoller	Director
Michael Miller	Plant Superintendent

WINTHER, STAVE & CO., LLP
Certified Public Accountants

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INDEPENDENT AUDITORS' REPORT

Board of Directors
Central Water System
Okoboji, IA 51355

We have audited the accompanying statement of net assets of Central Water System as of December 31, 2006 and the related statements of revenue, expenses, and changes in net assets, and cash flows for the year then ended. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards and provisions require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the basic financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Central Water System at December 31, 2006 and the changes in its financial position and its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 20, 2007 on our consideration of Central Water System's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The System has not presented management's discussion and analysis which introduces the basic financial statements by presenting certain financial information as well as management's analytical insight on that information that the Government Accounting Standards Board has determined is necessary to supplement, although not required to be a part of, the basic financial statements.

Wincher, Steve & Co LLP

June 20, 2007

BASIC FINANCIAL STATEMENTS

CENTRAL WATER SYSTEM
STATEMENT OF NET ASSETS
DECEMBER 31, 2006

ASSETS

CURRENTS ASSETS:

Cash and cash equivalents	\$ 26,974
Certificates of deposit	117,668
Accounts receivable	15,769
Prepaid expenses	15,536
Accrued interest receivable	<u>1,436</u>
TOTAL CURRENT ASSETS	<u>177,383</u>

NONCURRENT ASSETS:

Capital assets	3,079,442
Accumulated depreciation	<u>(1,384,936)</u>
Capital assets - net	<u>1,694,506</u>

Loan costs - net	<u>26,994</u>
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Restricted assets:

Bond sinking fund	8,609
Bond reserve fund	106,400
Bond improvement fund	<u>102,000</u>
Total restricted assets	<u>217,009</u>

TOTAL NONCURRENT ASSETS	<u>1,938,509</u>
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TOTAL ASSETS	<u>\$2,115,892</u>
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CENTRAL WATER SYSTEM
STATEMENT OF NET ASSETS
DECEMBER 31, 2006

LIABILITIES AND NET ASSETS

CURRENTS LIABILITIES:

Accounts payable	\$ 6,548
Accrued interest	5,446
Accrued payroll taxes	3,074
Current portion long-term debt	40,000
TOTAL CURRENT LIABILITIES	<u>55,068</u>

LONG-TERM DEBT (Note 3):

Revenue bonds payable	1,115,000
Less current portion above	<u>(40,000)</u>
TOTAL LONG-TERM DEBT	<u>1,075,000</u>

TOTAL LIABILITIES	<u>1,130,068</u>
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NET ASSETS:

Invested in capital assets - net of related debt	579,506
Restricted	217,009
Unrestricted	<u>189,309</u>
TOTAL NET ASSETS	<u>985,824</u>

TOTAL LIABILITIES AND NET ASSETS	<u>\$2,115,892</u>
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CENTRAL WATER SYSTEM
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
FOR THE YEAR ENDED DECEMBER 31, 2006

REVENUE:	
Operating income	<u>\$ 325,180</u>
OPERATING EXPENSES:	
Salaries - superintendent	41,351
Salaries - other	34,408
Chemicals	54,016
Repairs	36,275
Utilities	38,992
Payroll taxes	10,195
Employee insurance	19,964
General insurance	12,587
Lab supplies	4,772
Testing and lab fees	4,817
Vehicle expenses	2,036
Clothing allowance	616
Legal and professional	2,503
Office supplies and postage	1,565
Telephone	707
Board expense	650
Bond expense	800
Continuing education	225
Amortization	1,636
Depreciation	<u>78,815</u>
TOTAL OPERATING EXPENSES	<u>346,930</u>
OPERATING LOSS	<u>(21,750)</u>
NON-OPERATING INCOME (EXPENSE):	
Interest income	15,401
Other income	18,000
Interest expense	<u>(65,347)</u>
TOTAL NON-OPERATING INCOME (EXPENSE) - NET	<u>(31,946)</u>
CHANGE IN NET ASSETS	(53,696)
NET ASSETS - BEGINNING OF YEAR	<u>1,039,520</u>
NET ASSETS - END OF YEAR	<u>\$ 985,824</u>

CENTRAL WATER SYSTEM
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2006

CASH FLOWS FROM OPERATING ACTIVITIES:

Cash received from customers	\$ 325,934
Cash paid to suppliers	(191,342)
Cash paid to employees	(75,759)
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>58,833</u>

CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:

Principal paid on bonds	(40,000)
Interest paid on bonds	(65,347)
Income from antenna rental	18,000
NET CASH USED BY CAPITAL AND RELATED FINANCIAL ACTIVITIES	<u>(87,347)</u>

CASH FLOWS FROM INVESTING ACTIVITIES:

Interest received from investments	15,401
Proceeds from matured investments	67,651
Acquisition of investments	(64,809)
NET CASH PROVIDED BY INVESTING ACTIVITIES	<u>18,243</u>

NET CHANGE IN CASH AND CASH EQUIVALENTS (10,271)

CASH AND CASH EQUIVALENTS - BEGINNING 37,245

CASH AND CASH EQUIVALENTS - ENDING \$ 26,974

RECONCILIATION OF OPERATING LOSS TO
NET CASH PROVIDED BY OPERATIONS:

Loss from operations	\$ (21,750)
Adjustments to reconcile loss from operations to net cash provided by operating activities:	
Depreciation and amortization	80,451
(Increase) decrease in:	
Accounts receivable	754
Prepaid expenses	(1,073)
Accrued interest receivable	(1)
Increase (decrease) in:	
Accounts payable	304
Accrued expenses	<u>148</u>

NET CASH PROVIDED BY OPERATING ACTIVITIES \$ 58,833

CENTRAL WATER SYSTEM
NOTES TO FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2006

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Central Water System was organized by a Joint Public Improvement Agreement between the City of Arnolds Park and the City of Okoboji dated April 11, 1977. Central Water System, organized under the Code of Iowa, Chapter 28E, was designed to operate a water system to jointly serve the two municipalities. Iowa Lakes Regional Water was later added as a customer through a water purchase contract with Central Water System dated January 11, 1989. All facilities and land acquired or constructed in connection with the System are to be owned by the two municipal parties as tenants in common with undivided ownership interest.

Central Water System is operated by the parties through a joint Board of Directors consisting of one member from each city council, or such other individual as that council shall designate, and a third member appointed and approved by a majority vote of the city councils of the municipalities.

The System's financial statements are prepared in conformity with U.S. generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board.

Reporting Entity

For financial reporting purposes, Central Water System has included all funds, organizations, account groups, agencies, boards, commissions, and authorities. The System has also considered all potential component units for which it is financially accountable, and other organizations for which the nature and significance of their relationship with the System are such that exclusion would cause the System's financial statements to be misleading or incomplete. The Governmental Accounting Standards Board has set forth criteria to be considered in determining financial accountability. These criteria included appointing a voting majority of an organization's governing body, and (1) the ability of the System to impose its will on that organization or (2) the potential for the organization to provide specific benefits to, or impose specific financial burdens on the System. Central Water System has no component units which meet the Governmental Accounting Standards Board criteria.

Basis of Presentation

The accounts of Central Water System are organized as an Enterprise Fund. Enterprise Funds are used to account for operations (a) financed and operated in a manner similar to private business enterprises, where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges or (b) where the governing body has decided periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

Measurement Focus and Basis of Accounting

The financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

The System applies all applicable GASB pronouncements, as well as the following pronouncements issued on or before November 30, 1989, unless these pronouncements conflict with or contradict GASB pronouncements: Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions and Accounting Research Bulletins of the Committee on Accounting Procedure.

The System distinguishes operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the System's principal ongoing operations. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Assets and Liabilities

The following accounting policies are followed in preparing the Statement of Net Assets:

Cash and Cash Equivalents - For the purposes of the statement of cash flows, the System considers as cash and cash equivalents all currency on hand, demand deposits with banks or other financial institutions, certificates of deposit with an original maturity of three months or less, and other accounts that have the general characteristics of demand deposits in that the System may deposit additional funds at any time and also effectively may withdraw funds at any time without prior notice or penalty.

Accounts Receivable - Accounts receivable and revenue are recorded at the time that service is billed. Unbilled revenue for service consumed between periodic scheduled billing dates is not considered to have a material effect on the financial statements. Accounts are reviewed annually; accounts considered uncollectible are written off at that time.

Capital Assets - Capital assets are accounted for at historical cost. Depreciation of all exhaustible capital assets is charged as an expense against operations. The cost of repair and maintenance is charged to expense, while the cost of renewals or substantial betterments is capitalized. The cost and accumulated depreciation of assets disposed of are deleted, with any gain or loss recorded in current operations.

Reportable capital assets are defined by the System as assets with initial, individual costs in excess of the following thresholds and estimated useful lives in excess of two years.

<u>Asset Class</u>	<u>Amount</u>
Plant and distribution system	\$ 25,000
Equipment	\$ 5,000

Capital assets of the System are depreciated using the straight-line method over the following estimated useful lives:

<u>Asset Class</u>	<u>Estimated Lives (In Years)</u>
Plant and distribution system	10 - 40
Equipment and vehicles	5 - 15

Interest costs are capitalized when incurred on debt where proceeds were used to finance the construction of assets. Interest earned on proceeds of tax-exempt borrowing arrangements restricted to the acquisition of qualifying assets is offset against interest costs in determining the amount to be capitalized. The System had no capitalized interest during the year.

Other Assets - Loan costs are being amortized on a straight-line basis over 25 years and are presented at their net value.

Compensated Absences - Central Water System has established a written policy for sick leave and vacation accrual which states that no sick leave or vacation pay will accumulate one year to the next. Therefore, there are no accrued compensated absences at December 31, 2006.

Use of Estimates - The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Income Taxes - Central Water System is exempt from federal and state income taxes.

2. DEPOSITS AND INVESTMENTS

The System's deposits in banks at December 31, 2006 were entirely covered by federal depository insurance or by the State Sinking Fund in accordance with Chapter 12C of the Code of Iowa. This chapter provides for additional assessments against the depositories to insure there will be no loss of public funds.

The System is authorized by statute to invest public funds in obligations of the United States government, its agencies and instrumentalities; certificates of deposit or other evidences of deposit at federally insured depository institutions approved by the Board of Directors; prime eligible bankers acceptances; certain high-rated commercial paper; perfected purchase agreement; certain registered open-end management investment companies; certain joint investment trusts; and warrants or improvement certificates of a drainage district.

The System had no investments meeting the disclosure requirements of Government Accounting Standards Board Statement No. 3, as amended by Statement No. 40.

3. CAPITAL ASSETS

A summary of capital assets at December 31, 2006 is as follows:

	Balance Beginning of Year	Additions	Balance End of Year
Capital assets being depreciated:			
Plant and distribution system	\$3,007,999		\$3,007,999
Equipment	<u>71,443</u>	<u> </u>	<u>71,443</u>
Total capital assets being depreciated	<u>3,079,442</u>	<u> </u>	<u>3,079,442</u>
Less accumulated depreciation for:			
Plant and distribution system	1,261,898	\$ 73,617	1,335,515
Equipment	<u>44,222</u>	<u>5,199</u>	<u>49,421</u>
Total accumulated depreciation	<u>1,306,120</u>	<u>78,816</u>	<u>1,384,936</u>
Capital assets - net	<u>\$1,773,322</u>	<u>\$ (78,816)</u>	<u>\$1,694,506</u>

4. LONG-TERM DEBT

A summary of changes in long-term liabilities for the year ended December 31, 2006 is as follows:

	Balance Beginning of Year	Decreases	Balance End of Year	Due Within One Year
Revenue bonds:				
Series 1998A	\$1,140,000	\$25,000	\$1,115,000	\$40,000
Series 1998B	<u>15,000</u>	<u>15,000</u>	<u> </u>	<u> </u>
Total	<u>\$1,155,000</u>	<u>\$40,000</u>	<u>\$1,115,000</u>	<u>\$40,000</u>

One issue of unmatured revenue bonds, totaling \$1,115,000, is outstanding at December 31, 2006. The bonds are part of \$1,140,000 Series A Waterworks System Improvement Revenue Bonds issued in 1998. These bonds bear interest at a rate ranging from 4.50% to 5.75% per annum and mature in varying annual amounts ranging from \$40,000 to \$100,000, with the final maturity due in the year ending December 31, 2023.

The resolution providing for the issuance of the revenue notes includes the following provisions:

- (a) The bonds will only be redeemed from the future earnings of the enterprise activity and the bond holders hold a lien on the future earnings of the System.
- (b) Sufficient monthly transfers shall be made to a revenue bond sinking fund account for the purpose of making the note principal and interest payments when due.
- (c) Sufficient monthly transfers shall be made to a bond reserve fund for the purpose of bond principal and interest payments when insufficient funds are available in the bond sinking fund. Monthly transfers equal 25% of the transfer to the sinking fund until specific minimum balances have been accumulated.

- (d) Additional monthly transfers of \$1,000 to a separate improvement fund shall be made until specific minimum balances have been accumulated. These accounts are restricted for the purpose of paying for any additional improvements, extensions, or repairs to the system.
- (e) User rates shall be established at a level which produces net revenues at a level not less than 125% of the amount of principal and interest on the bonds falling due in the same year.

During the year ended December 31, 2006, the System failed to comply with the revenue bond provisions related to user rates.

A summary of the annual revenue bond principal and interest requirements to maturity is as follows:

<u>Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2007	\$ 40,000	\$ 63,306	\$ 103,306
2008	45,000	61,227	106,227
2009	45,000	58,865	103,865
2010	45,000	56,480	101,480
2011	50,000	54,050	104,050
2012 - 2016	300,000	223,099	523,099
2017 - 2021	395,000	126,499	521,499
2022 - 2023	<u>195,000</u>	<u>16,962</u>	<u>211,962</u>
Total	<u>\$1,115,000</u>	<u>\$ 660,488</u>	<u>\$1,775,488</u>

5. PENSION AND RETIREMENT BENEFITS

The System contributes to the Iowa Public Employees Retirement System (IPERS) which is a cost-sharing multiple-employer defined benefit pension plan administered by the State of Iowa. IPERS provides retirement and death benefits which are established by State statute to plan members and beneficiaries. IPERS issues a publicly available financial report that includes financial statements and required supplementary information. The report may be obtained by writing to IPERS, P.O. Box 9117, Des Moines, Iowa, 50306-9117.

Plan members are required to contribute 3.70% of their annual salary and the System is required to contribute 5.75% of annual covered payroll. Contribution requirements are established by State statute. The System's contributions to IPERS for the years ended December 31, 2006, 2005, and 2004 were \$4,356, \$4,192, and \$4,054, respectively, equal to the required contributions for each year.

457 Deferred Compensation Plan

The System offers a deferred compensation plan created in accordance with Internal Revenue Code Section 457 to System employees. The plan permits the employees to defer a portion of current salary until future years. The System does not contribute to the plan. Plan funds are held in trust by a third party investor. The System provides neither administrative service to the plan nor investment advice for the plan.

6. RISK MANAGEMENT

The System is a member of the Iowa Communities Assurance Pool, as allowed by Chapter 670.7 of the Code of Iowa. The Iowa Communities Assurance Pool (Pool) is a local government risk-sharing pool whose 531 members include various governmental entities throughout the State of Iowa. The Pool was formed in August 1986 for the purpose of managing and funding third-party liability claims against its members. The Pool provides coverage and protection in the following categories: general liability, automobile liability, automobile physical damage, public officials liability, police professional liability, property, inland marine, and boiler/machinery. There have been no reductions in insurance coverage from prior years.

Each member's annual casualty contributions to the Pool fund current operations and provide capital. Annual operating contributions are those amounts necessary to fund, on a cash basis, the Pool's general and administrative expenses, claims, claims expenses, and reinsurance expenses due and payable in the current year, plus all or any portion of any deficiency in capital. Capital contributions are made during the first six years of membership and are maintained to equal 300 percent of the total current members' basis rates or to comply with the requirements of any applicable regulatory authority having jurisdiction over the Pool.

The Pool also provides property coverage. Members who elect such coverage make annual operating contributions which are necessary to fund, on a cash basis, the Pool's general and administrative expenses and reinsurance premiums, all of which are due and payable in the current year, plus all or any portion of any deficiency in capital. Any year-end operating surplus is transferred to capital. Deficiencies in operations are offset by transfers from capital and, if insufficient, by the subsequent year's member contributions.

The Commission's property and casualty contributions to the risk pool are recorded as disbursements from its operating funds at the time of payment to the risk pool. The Commission's annual contributions to the Pool for the year ended December 31, 2006 were \$10,586.

The Pool uses reinsurance and excess risk-sharing agreements to reduce its exposure to large losses. The Pool retains general, automobile, police professional, and public officials' liability risks up to \$350,000 per claim. Claims exceeding \$350,000 are reinsured in an amount not to exceed \$2,650,000 per claim and \$5,000,000 in aggregate per year. For members requiring specific coverage from \$3,000,000 to \$10,000,000, such excess coverage is also reinsured. Automobile physical damage risks are retained by the Pool up to \$100,000 each occurrence, each location, with excess coverage reinsured on an individual-member basis.

The Pool's intergovernmental contract with its members provides that in the event a casualty claim or series of claims exceeds the amount of risk-sharing protection provided by the member's risk-sharing certificate, or in the event that a series of casualty claims exhausts total members' equity plus any reinsurance and any excess risk-sharing recoveries, then payment of such claims shall be the obligation of the respective individual member. As of June 30, 2006, settled claims have not exceeded the risk pool or reinsurance company coverage since the pool's inception.

Members agree to continue membership in the Pool for a period of not less than one full year. After such period, a member who has given 60 days' prior written notice may withdraw from the Pool. Upon withdrawal, payments for all claims and claims expenses become the sole responsibility of the withdrawing member, regardless of whether a claim was incurred or reported prior to the member's withdrawal. Members withdrawing within the first six years of membership may receive a partial refund of their capital contributions. If a member withdraws after the sixth year, the member is refunded 100% of its capital contributions; however, the refund is reduced by an amount equal to the annual operating contribution which the withdrawing member would have made for the one-year period following withdrawal.

The System also carries commercial insurance purchased from other insurers for coverage associated with workers' compensation. The System assumes liability for any deductibles and claims in excess of coverage limitations. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

7. MAJOR CUSTOMERS

During the year ended December 31, 2006, the System received approximately 92% of its revenues from two entities as follows:

	<u>Amount</u>	<u>Percent</u>
City of Arnolds Park	\$175,886	54%
City of Okoboji	\$124,998	38%

8. LITIGATION

The System may become party to routine legal proceedings and litigation arising in the normal course of governmental operations. These legal proceedings typically are not expected to have a material adverse impact on the System's financial condition.

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Certified Public Accountants

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**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL
REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON
AN AUDIT OF FINANCIAL STATEMENTS PERFORMED
IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

To the Board of Directors
Central Water System
Okoboji, IA 51355

We have audited the accompanying financial statements of Central Water System as of and for the year ended December 31, 2006 and have issued our report thereon dated June 20, 2007. We conducted our audit in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Central Water System's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing our opinion on the effectiveness of the System's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the System's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified a certain deficiency in internal control over financial reporting that we consider to be a material weakness.

A control deficiency exists when the design or operation of the control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the System's ability to initiate, authorize, record, process, or report financial data reliably in accordance with U.S. generally accepted accounting principles such that there is more than a remote likelihood a misstatement of the System's financial statements that is more than inconsequential will not be prevented or detected by the System's internal control. We consider the deficiency in internal control described in Part I of the accompanying Schedule of Findings to be a significant deficiency in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood a material misstatement of the financial statements will not be prevented or detected by the System's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe the significant deficiency noted above, item I-A-06, is a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Central Water System's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, non-compliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of non-compliance or other matters that are required to be reported under *Government Auditing Standards*.

Comments involving statutory and other legal matters about Central Water System's operations for the year ended December 31, 2006 are based exclusively on knowledge obtained from procedures performed during our audit of the financial statements of Central Water System. Since our audit was based on tests and samples, not all transactions that might have had an impact on the comments were necessarily audited. The comments involving statutory and other legal matters are not intended to constitute legal interpretations of those statutes.

The System's responses to findings identified in our audit are described in the accompanying Schedule of Findings. While we have expressed our conclusions on the System's responses, we did not audit the System's responses and, accordingly, we express no opinion on them.

This report, a public record by law, is intended solely for the information and use of the officials and employees of Central Water System and other parties to whom of Central Water System may report. This report is not intended to be and should not be used by anyone other than these specified parties.

We would like to acknowledge the many courtesies and assistance extended to us by personnel of Central Water System during the course of our audit. Should you have any questions concerning any of the above matters, we shall be pleased to discuss them with you at your convenience.

A handwritten signature in black ink that reads "Winther, Steve H. LHP". The signature is written in a cursive, flowing style.

June 20, 2007

CENTRAL WATER SYSTEM
SCHEDULE OF FINDINGS
FOR THE YEAR ENDED DECEMBER 31, 2006

Part I: Findings Related to the Financial Statements

Significant Deficiency:

I-A-06 Segregation of Duties - During our review of the internal control structure, existing procedures were evaluated in order to determine whether incompatible duties, from a control standpoint, are performed by the same employee. We noted that one individual is primarily responsible for all recordkeeping and reconciling functions for the System.

Recommendation - We realize with a limited number of office employees, segregation of duties is difficult. However, the System should review the operating procedures of the office to obtain the maximum internal control possible under the circumstances with continued administrative review by Directors.

Response - We continually review our operating procedures and strive to improve the internal control and segregation of duties whenever possible. Administrative and Board review of transactions and financial information is an important part of the controls in place, and is relied upon to strengthen controls.

Conclusion - Response accepted.

Instances of Noncompliance:

No matters were noted

CENTRAL WATER SYSTEM
SCHEDULE OF FINDINGS - Continued
FOR THE YEAR ENDED DECEMBER 31, 2006

Part II: Other Findings Related to Statutory Reporting

II-A-06 Questionable Expenses - We noted no expenses that may not meet the requirements of public purpose as defined in an Attorney General's opinion dated April 25, 1979.

II-B-06 Travel Expense - No expenditures of money for travel expenses of spouses of System officials or employees were noted.

II-C-06 Board Minutes - No transactions were found that we believe should have been approved in the System's minutes but were not.

II-D-06 Deposits and Investments - No instances of non-compliance with the deposit and investment provisions of Chapter 12B and Chapter 12C of the Code of Iowa were noted, except that the investment policy adopted in 1992 could not be located.

Recommendation - Unless the previously adopted investment policy can be located, we recommend the System adopt a current investment policy.

Response - Unless the previously adopted investment is located, we will adopt a current investment policy.

Conclusion - Response accepted.

II-E-0-6 Revenue Bonds - The System has complied with revenue bond provisions, except that the System has not maintained user rates at a level sufficient to produce net revenues to the extent required by the resolutions.

Recommendation - The System should review water user rates and increase them as needed to produce the required net revenues.

Response - The System will evaluate the water usage fees and consider adjusting them accordingly to produce the required level of net revenues.

Conclusions - Response accepted.